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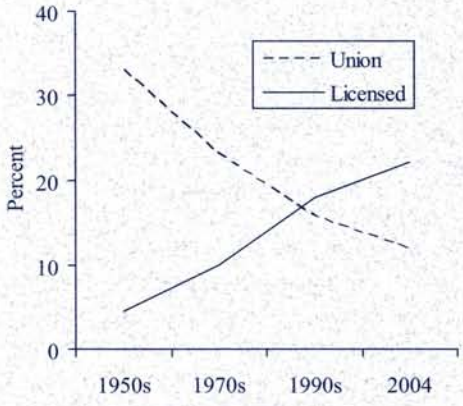
Regulating Occupations: Quality or Monopoly?

This article highlights some of the findings in the author's new book, Licensing Occupations: Ensuring Quality or Restricting Competition? *which is available from the Upjohn Institute* *(see p. 7).*

The licensing of occupations often is accused of being stealth regulation that operates under the public policy radar screen. Unlike other labor market institutions, such as laws regulating unions or the minimum wage, the regulation of occupations has received little attention by the press, academics, or policymakers. However, this lack of attention is not because occupational licensing is diminishing in the labor market. Figure 1 shows that the growth of occupational licensing in the United States has increased far more than unions, a more widely studied labor market institution. Since the 1950s, licensing coverage has grown from about 5 percent of the workforce to more than 20 percent, while unions have declined from about a third of the workforce to less than 13 percent, and to fewer than 8 percent in the private sector. Approximately 50 occupations are licensed in all states, and about 800 occupations are similarly regulated in at least one state.

Occupational regulation has varying levels of stringency. The toughest form of regulation is licensure, where it is illegal for a person to practice a profession without first meeting state standards, which usually involve detailed education requirements, testimonials of "good moral character," and a test. A second, less restrictive form of regulation is certification, which gives states a "right-to-title" protection for persons meeting predetermined standards. Those without certification may perform the duties of the occupation but may not use the title. A third and least restrictive form of

Figure 1 Comparisons in the Trends of Two Labor Market Institutions: Licensing and Unionization



SOURCE: Tabulations for licensing coverage for the 1950s are from the Council of State Governments (1952), which lists licensed occupations in the public use Census Sample for 1950. For the 1960s, the tabulations are from Greene (1969), which links the available listing of licensed occupations to census tabulations. The data for the 1980s are from Kleiner (1990) tabulations; new estimates were developed for 2000. Estimates for union density are from the Bureau of Labor Statistics (1979) and Hirsch and Macpherson (2005).

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regulation is registration, which usually requires individuals to file their names, addresses, and qualifications with a government agency before practicing in the occupation. Registration often includes posting a bond or filing a fee.

Although the regulation of individuals in occupations dates to ancient times, the guilds of medieval Europe are most often mentioned as examples of the imposition of tough restrictions on entering a craft or occupation. In the United States through much of the nineteenth century, few restrictions were imposed on occupations we often think of as licensed, such as doctors and lawyers. During the past 50 years, however, with the increase in complexity of jobs, especially in the service sector, licensing of individuals in their jobs emerged as one of the fastest-growing labor market institutions in the United States and other industrialized nations.

One of the major justifications for occupational licensing is that it increases service quality. Yet the available studies offer little evidence that licensing individuals has an impact on the quality of service received by consumers. For example, my examination of data from Wisconsin and Minnesota finds no evidence of differences in consumer complaints between Wisconsin, which licensed certain health care occupations, such as physical therapists, respiratory care providers, and physician assistants, and complaints to state boards in Minnesota, which certified the same occupations.

Malpractice insurance premiums can also serve as the arbitrator of the effectiveness of licensing as a way to mitigate the harmful effects of inept practitioners. If licensing works as intended, it should reduce mistakes by licensed relative to unlicensed practitioners. The insurance industry would then provide lower premiums for practitioners in regulated states because licensing statutes (such as testing and background checks) would have weeded out incompetent or unscrupulous practitioners. However, my examination of the rates charged nationally for practitioners who are licensed in some U.S. states and not in others reveals that no price breaks on malpractice in insurance premiums were given to practitioners in licensed states.

Table 1 Key Findings of the Impact of Licensing on Enhancing Quality or Restricting Competition

Issue	Key findings
Estimate of percent of workforce covered by licensing	Using Department of Labor and Census Data, percent of workforce covered by licensing is approximately 20 percent, a growth of 11 percent over the past 15 years.
Potential benefits of licensing	Increased standardization of services and reduction in the potential "loss aversion" by consumers due to poor quality service.
Evidence of the benefits of licensing	Some evidence that the insured and higher-income gain from stricter licensing but no measurable impact on overall quality.
Price and wage effects of licensing	Licensing drives up prices, and the overall wage effect relative to unlicensed occupations in cross-section data is 10–12 percent, but impacts differ widely based on methods, occupations, and toughness of restrictions.
Licensing and employment growth	Within an occupation, the percentage employment growth rate is approximately 20 percent greater in states that do not require licensing, but impacts differ widely based on the methods and occupations.
State variations in licensing	Much variation in the number of occupations licensed by states and the percent of the workforce covered by licensing laws. Case studies show that political spending by the occupational associations is an important factor for who gets regulated.
Redistribution and lost output due to licensing	Estimated redistribution effects to regulated occupations of between $116 billion and $139 billion in 2000 dollars, and lost output of $34.8 and $41.7 billion per year, which is less than 0.1 percent of total consumption expenditures.
U.S. and EU comparisons	Both economies regulate entry but there is often no exam beyond university or trade school to obtain a license for many of the professions in the EU. EU nations regulate prices charged and the organizational structure of the professions to a greater extent than the United States. Wage effects for licensing are around 1 percent using cross-section estimates, but the impacts vary widely based on methods, occupations, and toughness of restrictions.

Then what are the potential impacts of licensing? Restricting labor supply is one. For example, there was a decline in employment growth for librarians, respiratory therapists, and dietitians and nutritionists from 1990 to 2000 in those states that regulate these occupations relative those that do not. The estimates using census data show that, for the licensed occupations that were regulated in about one-half of all states, licensing reduced the percentage growth rate of employment by a statistically significant 20 percent. Therefore, it is not surprising that the impact of licensing on hourly earnings compared to similar unlicensed occupations was about 10–17 percent, depending on the occupations and the methods used in the analysis.

There is considerable variation among the states in the number of occupations licensed and in the percentage of the workforce that is covered by licensing laws. For example, California licenses almost 180 occupations that cover more than 30 percent of its workforce. On the other hand, Kansas licenses about 50 occupations, and these regulatory laws cover less than 12 percent of its workforce. If licensing has no productivity impacts yet increases spending, then simulations of the net expenses of the labor market regulation indicate it costs the economy about $38 billion in lost service output per year.

The regulation of occupations in Europe takes a somewhat different form from that in the United States. Rather than focusing on postgraduation tests, countries such as France, Germany, and the United Kingdom tend to regulate the prices charged and the organizational structure that is allowed by practitioners. With the smaller differences in the wage structure in Europe and the way occupations are licensed, the overall

impact of licensing on hourly wages is much smaller than in the United States.

The major empirical findings in *Licensing Occupations* are summarized in Table 1. Given these results of the labor market impacts of licensing, other forms of regulation, such as certification, are suggested. Alternative forms of occupational regulation may provide consumers with more choice than licensing and reduce the potential monopoly impacts of licensing in the labor market. In order to better monitor the economic impacts of licensing, data on this form of regulation should be provided to academics and policymakers in the major national labor market data sources, such as the Current Population Survey. With more data and analysis, the public, workers, and policymakers can more accurately assess whether occupational licensing is ensuring quality or restricting competition.

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John S. Earle

Employment and Wage Effects of Privatization

Evidence from Transition Economies

The greatest opposition to privatizing a firm usually comes from the firm's own employees, who are fearful of wage cuts and job losses. Workers' apprehensions about privatization are consistent with standard economic analyses, whereby new private owners reduce the firm's labor costs in response to harder budget constraints and stronger profit-related incentives. Discussions of this "efficiency effect" of privatization, however, implicitly assume that the firm's output remains constant or at least does not increase. But lower costs may increase the firm's market share as well as total quantity demanded for the industry, and the new private owners may be more entrepreneurial in marketing, innovation, and entering new markets. In such cases, the firm's output will tend to rise, and if this "scale effect" dominates, then privatization could cause a net employment increase.

The implications of privatization for wages are also ambiguous. New owners may reduce wages as part of a general cost-cutting policy, but if the firm expands, it may have to offer higher wages to attract new workers. New private owners may also be more likely to adopt skill-biased technologies, resulting in a compositional shift toward higher-paid workers. Depending on the relative strength of such factors, wages may either rise or fall as a result of privatization.

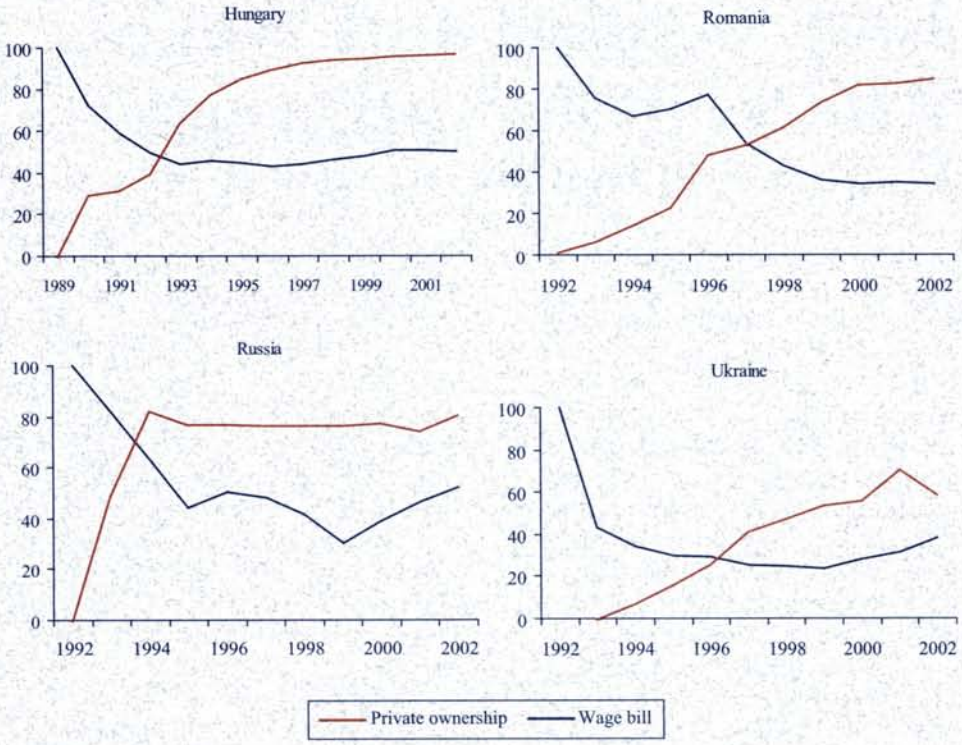
Not only does theoretical analysis fail to provide definitive predictions on the wage and employment effects of privatization, but also the existing empirical evidence is both scant and inconclusive, containing both negative and positive estimates of the effects on workers. Therefore, the Upjohn Institute, in collaboration with partners from Heriot-Watt University in Edinburgh and the Central European University Labor Project in Budapest, has recently undertaken an empirical analysis of the effects of privatization on the wage bill, employment, and wage rates of firms in Hungary, Romania, Russia, and Ukraine—countries where thousands of businesses were privatized in a relatively short period of time during the 1990s. These four countries had varied success with privatization reforms. Hungary was considered one of the most successful, Russia and Ukraine were less successful, and Romania was somewhere in the middle.

Figure 1 shows the evolution of the average real wage bill and percent private ownership in each country. At this aggregate level of analysis, a strong negative correlation is evident in all four countries, which would seem to corroborate workers' fears and most economists' expectations. However, several other events that could affect the wage bill occurred during the 1990s (including macroeconomic shocks and market liberalization), and the firms selected for privatization may have been declining for extraneous reasons. To deal with these potentially confounding factors and estimate the causal effects of privatization on workers, the project has analyzed microdata on firms that have been linked over time. The methods applied to estimate the privatization effects at the firm level draw upon some of those used in evaluations of labor market training programs in the United States.

Privatization Programs and Implications for Workers

The methods and tempos of large enterprise privatization differed quite significantly across the four countries in this study. Hungary got off to an early start in ownership transformation and maintained a consistent case-by-case

Figure 1 Evolution of Average Real Wage Bill and Private Ownership



NOTE: The graphs show an index of the average real wage bill and percent of majority private firms on the vertical axis, calculated from our data. The real wage bill is set at 100 in 1989 in Hungary and 1992 for Romania, Russia, and Ukraine.

method throughout the transition. Unlike many other countries, there were no significant incentives given to workers to acquire shares in their companies, nor was there a mass distribution of shares aided by vouchers. Hungarian privatization thus resulted in very little worker ownership (involving only about 250 firms), very little dispersed ownership, and instead significant managerial ownership and highly concentrated block-holdings, many of them foreign. Although the process appeared at times to be slow and gradual, in fact it was completed earlier than in most other East European countries.

In Romania, by contrast, the early attempts to mimic voucher programs and sell individual firms produced few results, and privatization really began only in late 1993, first with the program of Management and Employee Buyouts, and then with the mass privatization of 1995–1996. The consequences of these programs were large-scale employee ownership and dispersed shareholding by the general population, with little foreign involvement. Beginning in 1997, foreign investors became more involved, and blocks of shares were sold to both foreigners and domestic entities. The result was a mixture of several types of ownership and a moderate speed compared to Hungary.

Russia's and Ukraine's earliest privatization experiences have some similarities to the "spontaneous" period in Hungary, as the central planning system dissolved in the late 1980s and decision-making power devolved to managers and work collectives. In both countries, the initial consequence was large-scale ownership by managers and workers and some block-holding by domestic entities. Subsequently, privatization through sales became more common, secondary trading increased concentration, and foreigners made partial inroads.

These differences in privatization policy design could affect the impact of privatization on employment and wage outcomes through different impacts on the efficiency and scale effects of privatization. Worker-owners are likely to oppose labor-saving restructuring, for example, and they are unlikely to have incentives or resources to expand output. Outside block-holders, on the other hand, should favor cost-saving restructuring, particularly foreign investors with access to management skills, new technologies, and financing; they also are more likely to respond to opportunities for expansion. Outsiders with small shareholdings may also benefit from efficiency improvements and scale expansion, but they are unlikely to influence the firm's behavior. Therefore, both the efficiency and scale effects of privatization are likely to be smallest for domestic owners in countries where insider and mass privatization predominated, larger in cases where domestic outsiders acquired blocks of shares, and largest for privatization to foreign investors. Because these mechanisms are offsetting, however, the relative magnitudes of the effects of different types of privatization on workers are ambiguous.

Estimated Effects of Privatization

A first finding from detailed analyses of the firm-level data in this project is that, even before privatization, there are significant differences between firms that are privatized later and those that remain state-owned. Across the four countries in the analysis, the direction of the differences of firms later privatized to domestic investors is sometimes positive and sometimes negative. But the foreign differences are quite consistent, as firms that will be foreign-owned have higher wage bills, employment levels, and average wages than either pre-domestic firms or firms that always remain state-owned in all four countries. Moreover, not only the levels but the growth rates of these outcome variables display large preprivatization differences. These results imply that there may be some selection biases in the privatization process, and that simple comparisons across ownership types may be misleading. The empirical estimates of the privatization effects in this project therefore control for any fixed differences among firms and differing trend growth rates that may affect the probability of privatization, and whether the new owners are domestic or

foreign investors. We compare alternative estimators using several specification tests, including variants of the "pre-program" test, which measures selection bias of an estimator as the difference in the dependent variable prior to treatment between the treated and comparison groups. In the privatization context, this test must be evaluated before the privatization year to avoid possible contamination through anticipatory effects.

The results from these estimations imply that, on average, privatization has had little effect on the wage bill. If the wage bill represents a summary indicator of worker welfare, the firm-level analysis in this project does not support the common belief that privatization hurt workers. When new domestic owners are distinguished from foreign investors, the results for the former tend to be similar to the overall private results, as domestic owners dominate in most privatized companies. The results also provide no support for the widespread fear of foreign owners; on the contrary, they provide strong evidence that foreign owners increased the wage bill in the two Central and East European countries in our study, and in the two formerly Soviet republics the effect seems to be zero in the most pessimistic case.

These results for the wage bill can be decomposed into component parts, as shown in Table 1 for employment and in Table 2 for wages. The tables show two alternative specifications that differ only on whether firm-specific trends are controlled for in the estimation procedure; in both cases firm fixed effects are included. The effects of domestic privatization on either employment or wages differ very little across the two specifications, in no case showing large negative effects. The largest in magnitude are the implied 3–5 percent reduction in wages in domestically privatized firms in Hungary and Russia.

The estimated effects of foreign privatization are positive for both employment and wages in both specifications in every country. The inclusion of firm-specific trends does make a substantial difference to the magnitude and statistical significance of the results, with substantial and significant impacts remaining for employment in Hungary and for wages in Hungary and Romania. Specification tests are somewhat inconclusive about whether it is best to include the firm-specific trends on statistical grounds, so the results are somewhat ambiguous as to whether the benefits of foreign privatization for employment and wages are uniformly strongly positive or sometimes merely weakly positive. In all cases, however, the data reject the proposition that the effects are strongly negative.

Table 1 Employment Effects of Privatization

	Hungary	Romania	Russia	Ukraine
No trends				
Domestic	–0.030	0.187**	–0.007	0.017
	(0.035)	(0.026)	(0.006)	(0.009)
Foreign	0.428**	0.285**	0.152**	0.135
	(0.073)	(0.086)	(0.043)	(0.077)
With trends				
Domestic	0.002	–0.030	0.005	–0.006
	(0.024)	(0.017)	(0.004)	(0.008)
Foreign	0.154**	0.000	0.043	0.030
	(0.050)	(0.068)	(0.041)	(0.070)

NOTE: Foreign = 1 if the majority of the firm's shares are owned by foreigners in year $t-1$. Domestic = 1 if the firm was private in year $t-1$ but not majority-owned by foreigners. "No trends" specification includes firm fixed effects and industry-year interactions; "with trends" adds individual firm trends. Standard errors (corrected for firm clustering) are shown in parentheses. * = significant at the 5% level. ** = significant at the 1% level.

Table 2 Wage Effects of Privatization

	Hungary	Romania	Russia	Ukraine
No trends				
Domestic	–0.027	–0.023	–0.047**	0.003
	(0.015)	(0.012)	(0.008)	(0.011)
Foreign	0.307**	0.235**	0.244**	0.304**
	(0.033)	(0.054)	(0.064)	(0.095)
With trends				
Domestic	–0.045**	0.006	–0.032**	–0.004
	(0.016)	(0.013)	(0.007)	(0.011)
Foreign	0.066*	0.116*	0.019	0.079
	(0.033)	(0.057)	(0.063)	(0.097)

NOTE: Foreign = 1 if the majority of the firm's shares are owned by foreigners in year $t-1$. Domestic = 1 if the firm was private in year $t-1$ but not majority-owned by foreigners. "No trends" specification includes firm fixed effects and industry-year interactions; "with trends" adds individual firm trends. Standard errors (corrected for firm clustering) are shown in parentheses. * = significant at the 5% level. ** = significant at the 1% level.

Efficiency and Scale Effects

The results from this research suggest—contrary to the expectations of many workers, policymakers, and economists—that average wages and employment have not been substantially reduced by either domestic or foreign privatization. As discussed earlier, however, privatization may affect firm scale and efficiency in ways that produce opposing effects on workers. The lack of negative consequences could result from new private owners failing to improve efficiency, or it could result from scale

effects that offset the efficiency effects of private ownership. To explore these possibilities, it is useful to decompose the estimated impact of privatization on the wage bill into unit labor cost reduction (efficiency) and output expansion (scale) effects.[1]

The results of this decomposition show a striking regularity: foreign owners have been much more active in both dimensions than domestic owners. Although smaller, the scale effect is positive in each country for domestic privatization with the exception of Russia, where it is negative but small and statistically insignificant. The efficiency effect measured as unit labor cost reduction is positive for all countries and both ownership forms, although again it is larger under foreign ownership. This regularity holds for the scale effect measured as the effect of privatization on output and for the efficiency effect measured as unit labor cost reduction within each country. The scale effect is not only positive and significant in each country for foreign privatization, but also for domestic privatization with the exception of Russia, where it is negative but small and statistically insignificant. The efficiency effect measured as unit labor cost reduction is positive for all countries and both ownership forms, although again it is larger under foreign ownership.

The effects vary widely across countries: while the foreign effects are similar for Hungary, Romania, and Ukraine, they are substantially smaller in Russia. But the domestic pattern is still more pronounced, as Hungary and Romania show sizable scale and efficiency effects of domestic ownership, while both effects are negligible in Russia and Ukraine. Thus, the cross-country domestic wage bill patterns (small and negative everywhere) mask large differences in scale and efficiency effects.

Conclusion

Although economic analyses of the effects of privatization have focused almost entirely on firm performance, the greatest political and social controversies have usually concerned the consequences for the firm's employees. In most cases, it has been assumed that the employment and wage effects would be negative, and workers all around the world have reacted to the prospect of privatization, especially that to foreigners, with protests and strikes. Yet there have been very few systematic studies of the relationship between privatization and outcomes for the firm's workers, and previous research has been hampered by small sample sizes, short time series, and little ability to control for selection bias. It has therefore remained unclear whether workers' fears of privatization are in fact warranted.

The new research in this project, however, finds no evidence of large systematic negative consequences of privatization for employment and wages. In two of the four countries studied, small negative effects on wages are estimated for domestic privatization, but they are indeed quite small (minus 3–5 percent). By contrast, privatization to foreign investors produces consistently positive effects on the wage bill, employment, and wages in all four countries, regardless of estimation technique. The precise magnitudes vary with the econometric specification, but even in the most demanding specification for the data, the foreign results are positive and sometimes they are large and statistically significant.

The project also investigates the two alternative mechanisms through which privatization may affect outcomes for workers: efficiency and scale. The negligible effects of domestic privatization imply that these effects are largely offsetting. In Hungary and Romania, however, the offsetting scale and efficiency effects have both been large, while in Russia and Ukraine they have been small. Foreign privatization has resulted in much larger efficiency effects in all four countries, but still much larger scale effects, resulting in the increased employment and wages in foreign-owned firms that we observe after privatization.

An important caveat is that privatization may affect other aspects of worker welfare, including employment turnover, fringe benefits, and other work conditions. The data used in the project do not follow workers who are displaced, nor do they provide information on the alternative jobs for workers who are hired. The project therefore does not carry out a complete welfare evaluation of privatization, but it does provide new information on the effects on the wage bill, employment, and average wages at privatized firms, effects that would be important elements in such an evaluation.

Subject to this caveat, the results of the project imply that efficiency-enhancing owners may be good for workers, at least in terms of average employment and wage levels. Greater efficiency helps firms expand sales, reducing the likelihood of severe distress and raising labor demand. Workers' employment and wage prospects are never systematically diminished by privatization, and in some cases—particularly with foreign ownership—they actually brighten.

Notes

This article is based on Upjohn Institute Working Paper No. 05-125, "Does Privatization Hurt Workers? Lessons from Comprehensive Manufacturing Firm Panel Data in Hungary, Romania, Russia, and Ukraine," by J. David Brown, John S. Earle, and Almos Telegdy.

1. The wage bill is by definition unit labor cost times output, and therefore the proportional effect of privatization on the wage bill equals the proportional effect on unit labor cost plus the proportional effect on output.

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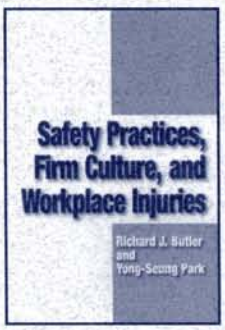
New Books

Safety Practices, Firm Culture, and Workplace Injuries

Richard J. Butler
Yong-Seung Park

In 2001, there were approximately 3.7 fatal workplace injuries per 100,000 workers (including 9/11), workers made 2.1 million trips to the emergency room, and workers' compensation insurance cost employers $63.9 billion. In addition, the indirect costs of workplace accidents—lost wages, equipment damage, and training and rehabilitation—were several times this amount. Despite the fact that human resource management (HRM) practices can directly affect the severity and costs of such accidents, HRM is usually seen as an auxiliary function that does not contribute to a firm's output.



Butler and Park draw attention to this oversight by presenting analysis of the impact of various HRM practices on firms' workers' compensation costs; specifically, which practices lower firms' workers' compensation costs and whether the impact is the result of changes in technical efficiency or induced changes in workers' behavior. They conclude with a set of policy implications for firms, workers, and workers' compensation policy.

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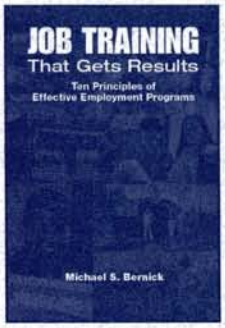
Job Training That Gets Results

Ten Principles of Effective Employment Programs

Michael S. Bernick

Recognizing that training programs can't be all things to all people, Michael Bernick, a former director of California's Employment Development Department, shows the types of training programs that do work and for whom. He identifies ways to improve performance among Workforce Investment Act (WIA) contractors while exploring the best uses for state discretionary WIA funds.



He also describes what it takes to make an effective career ladder program, how postemployment welfare retention or skill advancement programs can succeed, and the type of training that workers with disabilities must go through to get and retain jobs.

"With fresh insights gleaned from decades of experience, Michael Bernick addresses the human-capital challenge of preparing low-wage workers for the global economy. His realistic focus on incentives provides a road map for future policy." *—Michael Milken, chairman, Milken Institute*

"In this book, Mr. Bernick goes beyond the conventional social welfare and social services strategies for unemployed and low income workers. He shows how our nation's job training systems can be reshaped to get results." *—Sen. Dianne Feinstein, D-California*

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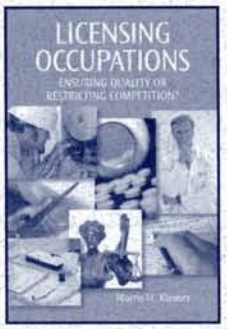
Licensing Occupations

Ensuring Quality or Restricting Competition?

Morris M. Kleiner

"Morris Kleiner has produced the most thorough evaluation of the effects of occupational licensing in years, perhaps ever. In a rational world, this book would provoke interest by policymakers and the public in reconsidering where occupational licensing is beneficial for society, and where it is beneficial for those lucky enough to be granted licenses but not for society as a whole." *—Alan B. Krueger, Princeton University*



"If you thought licensing was a boring minor issue in the labor market, this book will make you think again. Kleiner shows that a larger proportion of the workforce is licensed than is in unions, and that licensing raises wages and lowers employment without demonstrably improving the quality of services." *—Richard B. Freeman, Harvard University*

"In Licensing Occupations, Morris Kleiner opens the way for a long-overdue national dialogue on the efficacy of the U.S. professional and occupational regulatory system. His work will surely excite numerous and varied responses from public protection stakeholders." *—Pam Brinegar, Council on Licensure, Enforcement, and Regulation (CLEAR)*

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